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TAGS: ECON VE EIND PGOV
SUBJECT: Venezuela's Guayana Region: Basic Industries Deteriorating Rapidly as State Control Increases

CLASSIFIED BY: DUDDY, AMBASSADOR, DOS, AMB; REASON: 1.4(B), (D)

¶1. (C) Summary: The financial situation and productivity of the state-owned basic industries of Venezuela's Guayana region are deteriorating rapidly as the Venezuelan government (GBRV) increases its political control over them. The case of steel maker Sidor, which the GBRV took control of in July 2008 is perhaps emblematic: production has fallen 28 percent from 2007 to 2009 even as its workforce has increased substantially. Similar problems reportedly exist at other state-owned companies involved in iron ore mining, the aluminum production chain, and electricity generation. The GBRV has responded to the perfect storm of lower production, higher costs, and lower commodities prices by subsidizing the companies, deferring payments to suppliers, and reducing or delaying benefits to workers. End summary.

¶2. (SBU) This cable draws on meetings conducted by Emboffs in Ciudad Guayana, the economic heart of the Guayana region, on December 2-4, 2009. A separate cable will discuss the consequences of the deteriorating economic situation in the basic industries on labor unions, society at large and domestic politics.

The Basic Industries: An Ambitious Alternative to Oil

¶3. (U) Large-scale economic development began in the resource-rich Guayana region of Venezuela in the 1950s, when the government granted iron ore concessions to two U.S. companies and began to exploit the Caroni river's vast hydroelectric potential. (Note: The Guayana region encompasses the states of Bolivar, Amazonas, and Delta Amacuro; the southern parts of Guarico, Anzoategui, and Monagas; and the south-eastern part of Apure. End note.) President Carlos Andres Perez invested significant state resources in the region during his first administration (1974-1979), viewing the development of so-called "basic industries" in Guayana as a way to diversify Venezuela's economy away from oil. Over the 1970s and 80s most of the basic industries companies came to be fully or majority-owned by the Corporacion Venezolana de Guayana (CVG), a state-owned holding company also charged with planning the region's development. The most significant of these companies included Edelca (electricity generation); Sidor (steel production);

Ferrominera (iron ore mining); Bauxilum (mining and processing of bauxite to make alumina); Venalum and Alcasa (aluminum production from alumina); and Carbonorca (carbon anodes). The basic industries form the heart of the Guayana region's economy, supporting directly or indirectly up to 80 percent of the area's economic activity according to an estimate by a local business chamber. The Guayana region in turn is a key contributor to Venezuela's economy, with power from the Caroni dams alone supplying 70 percent of the country's electricity.

Enter President Chavez: Socialist Politics Upsets the Economic Balance

¶4. (C) Upon taking office in 1999, President Chavez stopped a trend toward privatization in the basic industries that included the sale of 60 percent of Sidor to an Argentine-Italian conglomerate in 1998 but did not make significant changes in the management of the CVG companies. According to journalist Damian Prat (strictly protect throughout), an expert on the basic industries, the GBRV managed the CVG companies with some of the inefficiencies one might expect in state-owned enterprises, but "nothing drastic or bad." In Prat's view, the situation changed in 2005, after a December 2004 meeting in which Chavez directed his ministers and allies to make a concerted push toward a more socialist economic model.

¶5. (C) In conjunction with this push, according to Prat, GBRV managers increasingly made business decisions based on political criteria, with predictable results. To illustrate, Prat related an anecdote about an abrupt decision by Venalum in 2005 to stop selling aluminum to U.S. buyers. The company could not find substitute buyers in Latin America and had to return to the U.S. market, with the misadventure reportedly costing USD 100 million. This may not be the only such incident: according to Pedro Rondon (strictly protect throughout), spokesperson for a group of current and former Sidor employees who have a 20 percent share in the company, Minister of Basic Industry and Mining Rodolfo Sanz recently directed Sidor's management to stop selling steel to Colombia and suggested Iran as a substitute market despite the higher transportation costs.

¶6. (C) In Prat's view large payroll increases are another indicator of the increasing primacy of political considerations, as GBRV managers have doled out coveted jobs in the basic industries as a quid pro quo for political support. Prat estimated that the number of workers had increased 30 to 50 percent in the past four years at many of the basic industries. Many of our contacts independently confirmed this estimate. Edelca engineer Rafael Salazar (strictly protect throughout; contact made with Econoff thanks to an alert Consular officer) said Edelca's workforce had doubled from three to six thousand workers in the past five years. A Venalum labor leader told us its payroll had increased from 2.5 to four thousand workers in the past several years.

Sidor's Nationalization Heralds Increased Central Government Control

¶7. (C) Prat believes the decision to (re)nationalize Sidor in 2008, a watershed development for the region's economic orientation, was also made strictly on political criteria. According to Prat, Sanz and other key GBRV figures had decided to back Techint, Sidor's Argentina-based majority owner, in an acrimonious negotiation with workers. Then "it all changed in a week" as President Chavez saw an opportunity to obtain a needed political boost in advance of regional elections by taking over

Sidor and portraying himself as a champion of workers' rights. Building on Sidor's nationalization, Chavez announced the nationalization of four iron briquette manufacturers in May 2009. Ironically, political considerations may have spared at least one of the companies for the time being. According to lawyer and company director Jose Santiago Nunez [strictly protect throughout], Comsigua, which is majority-owned by Japanese investors, has been spared to date because of GBRV concerns its nationalization would affect potential Japanese financing in the petroleum sector.

¶8. (C) One month after announcing the briquette nationalizations, Chavez launched the "Plan Socialista Guayana 2009-2019" in June ¶2009. This plan, the goal of which is to convert Guayana into a "socialist zone" by the end of 2012, contemplates changes that will increase and centralize GBRV economic control over the region. Under the plan, the GBRV would create two new Caracas-based corporations, one for iron and one for aluminum, to oversee the respective production chains from mining to manufacturing of finished products. If the experience of Edelca, which was subsumed into the national electricity company Corpoelec created in 2007, is any guide, the creation of these new corporations will further reduce the efficiency and remaining capacity for autonomous decision-making of the iron and aluminum companies. Salazar related that requests for necessary equipment to maintain Edelca's dams on the Caroni river now take up at least two years to be

processed through Corpolec's bureaucracy.

The Perfect Storm Hits...

¶9. (C) Increased political control and the push toward centralized "socialism" have reduced production and productivity in the basic industries. By all accounts Sidor's production has fallen significantly under GBRV control. Citing company statistics through November, a recent newspaper report estimated production would be 28 percent lower in 2009 than in 2007. Prat and Rondon separately estimated a drop from 4.3 million tons of steel in 2007 to 3 million tons in 2009, or a drop of 30 percent. While we have not seen recent production estimates for other major basic industries companies, the steep declines in mining and manufacturing reported by the Central Bank (18 and nine percent respectively for the third quarter of 2009) suggest their production is declining as well. With production declining and the workforce increasing, productivity is terrible. According to a report by an industry chamber in Guayana, productivity per worker in bauxite mining is 68 percent lower than in Brazil's Para state; in alumina production, 49 percent lower; and in aluminum production, 57 percent lower in the case of Venalum and 86 percent lower in the case of Alcasa, whose technology is notoriously obsolete.

¶10. (C) The trends described above have taken their toll on the financial performance of the state-owned basic industries for several years. According to Prat, even Venalum, which he says was "a King Midas in revenue," began to lose money in 2006 after showing profits of USD 80 million in 2005. (Note: The GBRV through the CVG owns 80 percent of Venalum; a Japanese consortium owns the remaining 20 percent. End note.) The sharp decline in commodity prices in the second half of 2008 completed what some have described as the perfect storm for the basic industries. Citing Sidor statistics and Rondon, the newspaper report mentioned above claimed Sidor was expected to lose USD 410 million in 2009 after posting profits of USD 685 million in 2007. (Note: The CVG and associated companies do not publish financial statements. End note.) The Guayana industry chamber estimates that Venalum's production costs are USD 3,000 per ton and Alcasa's are USD 4,200 per ton (as compared to the current world price of roughly USD

2,250 per ton). As a result, it predicted an overall deficit in the aluminum sector in 2009 of USD 1.3 billion dollars. (Note: Aluminum prices have risen slightly since this estimate was made. End note.)

...And the GBRV Struggles to Respond

¶11. (C) The GBRV has sought to cover the deficits created by this perfect storm in several ways: delaying payments to suppliers and cutting back on purchases; delaying or reducing benefits to workers; seeking to raise cash through debt issuance or future product sales; and, finally, subsidizing the basic industries from central government funds. Although much of the debt owed to suppliers remains within the public sector (i.e., if Sidor delays payment to Edelca), Gabriela Bellizzi (strictly protect throughout), a regional manager for Venezuela's largest bank (Banesco), estimated the basic industries owed up to USD 700 million to private suppliers in the region. While the CVG has considered but not yet followed through with a debt issuance of USD 1 billion or more, contacts in the industry chamber claimed Venalum was selling future aluminum production to international commodities companies such as Glencore, thus "gaining the oxygen to live until tomorrow." According to press reports, on December 23 China and

Venezuela signed an accord whereby the China Development Bank Corporation will extend a USD 1 billion line of credit to Venezuela, ostensibly to be used to finance the CVG.

¶12. (SBU) Given the opacity of GBRV finances, it is impossible to estimate accurately the magnitude of the subsidy the central government is providing to the basic industries. In an August 2009 speech discussing advances in the Plan Guayana Socialista, Chavez announced subsidies for investments of USD 313 million over five years. In late November 2009, the National Assembly approved the disbursement of 500 million bolivars (USD 230 million at the official exchange rate) to pay Christmas bonuses for workers in several key basic industries companies that apparently lacked the cash to make the payments themselves. (Note: These bonuses, which are normally paid in late October, were finally paid December 4. End note.) These amounts almost certainly represent a small part of central government subsidies to the basic industries.

Comment

¶13. (C) The Guayana region is at the economic vanguard of President Chavez's socialist vision. Through the basic industries, the state's presence in the region's economy is pervasive and growing. Aside from Venezuela's principal petroleum producing areas, the Guayana region is one of the most significant contributors to Venezuela's economy with its important hydropower, iron/steel, and aluminum sectors. Chavez has referred to the region as a "laboratory for socialism" but this experiment is apparently failing from an economic standpoint. Before oil and commodity prices fell in the second half of 2008 to complete the perfect storm, the GBRV could cover modest but growing deficits at the state-owned basic industries with oil proceeds. The GBRV has managed to muddle through 2009, but with measures that will be difficult to sustain economically. Barring a steep increase in oil and commodity prices, 2010 is likely to be a difficult year economically for the Guayana region. End comment.
DUDDY